

Morningstar, Inc.
Form 10-Q
October 30, 2012

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED September 30, 2012

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number: 000-51280

MORNINGSTAR, INC.

(Exact Name of Registrant as Specified in its Charter)

Illinois

(State or Other Jurisdiction of
Incorporation or Organization)

36-3297908

(I.R.S. Employer
Identification Number)

22 West Washington Street

Chicago, Illinois

(Address of Principal Executive Offices)

(312) 696-6000

(Registrant's Telephone Number, Including Area Code)

60602

(Zip Code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

As of October 26, 2012, there were 47,131,295 shares of the Company's common stock, no par value, outstanding.

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PART 1. FINANCIAL INFORMATION

Item 1. Financial Statements

Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Income

	Three months ended September 30		Nine months ended September 30	
(in thousands except per share amounts)	2012	2011	2012	2011
Revenue	\$ 160,952	\$ 160,051	\$ 487,679	\$ 472,829
Operating expense (1):				
Cost of goods sold	47,711	48,074	147,479	133,929
Development	12,857	13,482	38,664	39,151
Sales and marketing	25,732	27,253	81,431	80,502
General and administrative	23,966	26,431	77,090	83,255
Depreciation and amortization	10,822	10,947	31,616	31,712
Total operating expense	121,088	126,187	376,280	368,549
Operating income	39,864	33,864	111,399	104,280
Non-operating income (expense):				
Interest income, net	1,719	797	3,848	1,142
Other income (expense), net	161	(1,376)	(314)	(938)
Non-operating income (expense), net	1,880	(579)	3,534	204
Income before income taxes and equity in net income of unconsolidated entities	41,744	33,285	114,933	104,484
Income tax expense	15,186	12,343	41,441	35,585
Equity in net income of unconsolidated entities	478	428	1,541	1,397
Consolidated net income	27,036	21,370	75,033	70,296
Net loss attributable to the noncontrolling interest	34	10	62	106
Net income attributable to Morningstar, Inc.	\$ 27,070	\$ 21,380	\$ 75,095	\$ 70,402
Net income per share attributable to Morningstar, Inc.:				
Basic	\$ 0.56	\$ 0.42	\$ 1.53	\$ 1.40
Diluted	\$ 0.56	\$ 0.42	\$ 1.51	\$ 1.37
Dividends per common share:				
Dividends declared per common share	\$ 0.10	\$ 0.05	\$ 0.30	\$ 0.15
Dividends paid per common share	\$ 0.10	\$ 0.05	\$ 0.30	\$ 0.15
Weighted average shares outstanding:				

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Basic	47,975	50,278	49,028	50,082
Diluted	48,481	51,123	49,664	51,071

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	Three months ended September		Nine months ended September	
	30 2012	2011	30 2012	2011
(1) Includes stock-based compensation expense of:				
Cost of goods sold	\$1,148	\$1,117	\$3,304	\$3,068
Development	471	545	1,435	1,588
Sales and marketing	493	489	1,433	1,392
General and administrative	1,882	1,800	5,422	5,395
Total stock-based compensation expense	\$3,994	\$3,951	\$11,594	\$11,443

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Comprehensive Income

(in thousands)	Three months ended September		Nine months ended September	
	30 2012	2011	30 2012	2011
Consolidated net income	\$27,036	\$21,370	\$75,033	\$70,296
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	7,375	(12,570)	5,597	(6)
Unrealized gains (losses) on securities:				
Unrealized holding gains (losses) arising during period	1,026	(1,871)	1,394	(1,472)
Reclassification of (gains) losses included in net income	—	81	33	(171)
Other comprehensive income (loss)	8,401	(14,360)	7,024	(1,649)
Comprehensive income	35,437	7,010	82,057	68,647
Comprehensive (income) loss attributable to noncontrolling interest	16	(47)	77	52
Comprehensive income attributable to Morningstar, Inc.	\$35,453	\$6,963	\$82,134	\$68,699

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Balance Sheets

(in thousands except share amounts)	As of September 30 2012	As of December 31 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 152,181	\$ 200,437
Investments	190,899	269,755
Accounts receivable, less allowance of \$723 and \$835, respectively	119,877	113,312
Deferred tax asset, net	2,156	5,104
Income tax receivable, net	5,277	7,445
Other	22,546	15,980
Total current assets	492,936	612,033
Property, equipment, and capitalized software, net	77,873	68,196
Investments in unconsolidated entities	38,278	27,642
Goodwill	321,134	318,492
Intangible assets, net	122,832	139,809
Other assets	8,330	5,912
Total assets	\$ 1,061,383	\$ 1,172,084
Liabilities and equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 40,356	\$ 41,403
Accrued compensation	55,131	73,124
Deferred revenue	164,360	155,494
Other	319	612
Total current liabilities	260,166	270,633
Accrued compensation	6,802	5,724
Deferred tax liability, net	14,262	15,940
Deferred rent	15,160	14,604
Other long-term liabilities	8,262	8,167
Total liabilities	304,652	315,068
Equity:		
Morningstar, Inc. shareholders' equity:		
Common stock, no par value, 200,000,000 shares authorized, of which 47,479,142 and 50,083,940 shares were outstanding as of September 30, 2012 and December 31, 2011, respectively	5	5
Treasury stock at cost, 4,125,568 shares as of September 30, 2012 and 980,177 shares as of December 31, 2011	(232,685)	(46,701)
Additional paid-in capital	509,896	491,432
Retained earnings	469,295	409,022
Accumulated other comprehensive income (loss):		
Currency translation adjustment	7,548	1,936
Unrealized gain (loss) on available-for-sale investments	1,103	(324)
Total accumulated other comprehensive income	8,651	1,612
Total Morningstar, Inc. shareholders' equity	755,162	855,370
Noncontrolling interest	1,569	1,646

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Total equity	756,731	857,016
Total liabilities and equity	\$1,061,383	\$1,172,084

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries
 Unaudited Condensed Consolidated Statement of Equity
 For the nine months ended September 30, 2012

(in thousands, except share amounts)	Morningstar, Inc. Shareholders' Equity					Accumulated	Non-Controlling Interests	Total Equity
	Common Stock Shares Outstanding	Par Value	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Other Comprehensive Income (Loss)		
Balance as of December 31, 2011	50,083,940	\$5	\$(46,701)	\$491,432	\$409,022	\$1,612	\$1,646	\$857,016
Net income (loss)		—	—	—	75,095	—	(62)	75,033
Other comprehensive income (loss):								
Unrealized gain on available-for-sale investments, net of income tax of \$794		—	—	—	—	1,394	—	1,394
Reclassification of adjustments for losses included in net income, net of income tax of \$19		—	—	—	—	33	—	33
Foreign currency translation adjustment, net		—	—	—	—	5,612	(15)	5,597
Other comprehensive income (loss), net		—	—	—	—	7,039	(15)	7,024
Issuance of common stock related to stock-option exercises and vesting of restricted stock units, net	561,276	—	1,114	1,646	—	—	—	2,760
Stock-based compensation — restricted stock units		—	—	9,944	—	—	—	9,944
Stock-based compensation — restricted stock		—	—	1,332	—	—	—	1,332
Stock-based compensation — stock-options		—	—	318	—	—	—	318
Excess tax benefit derived from stock-option exercises and vesting of restricted stock units		—	—	5,007	—	—	—	5,007
Common shares repurchased	(3,166,074)	—	(187,098)	—	—	—	—	(187,098)
Dividends declared — common shares outstanding		—	—	—	(14,587)	—	—	(14,587)
Dividends declared — restricted stock units		—	—	217	(235)	—	—	(18)
Balance as of September 30, 2012	47,479,142	\$5	\$(232,685)	\$509,896	\$469,295	\$8,651	\$1,569	\$756,731

See notes to unaudited condensed consolidated financial statements.

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Morningstar, Inc. and Subsidiaries

Unaudited Condensed Consolidated Statements of Cash Flows

(in thousands)	Nine months ended September	
	2012	2011
Operating activities		
Consolidated net income	\$75,033	\$70,296
Adjustments to reconcile consolidated net income to net cash flows from operating activities:		
Depreciation and amortization	31,616	31,712
Deferred income taxes	492	(1,559)
Stock-based compensation expense	11,594	11,443
Provision for bad debt	990	1,076
Equity in net income of unconsolidated entities	(1,541)	(1,397)
Excess tax benefits from stock-option exercises and vesting of restricted stock units	(5,007)	(7,621)
Other, net	342	1,607
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(6,569)	(403)
Other assets	(3,551)	1,996
Accounts payable and accrued liabilities	(4,316)	(5,275)
Accrued compensation	(20,851)	(3,242)
Income taxes—current	7,220	9,442
Deferred revenue	7,684	618
Deferred rent	291	(984)
Other liabilities	(1,111)	(1,393)
Cash provided by operating activities	92,316	106,316
Investing activities		
Purchases of investments	(134,929)	(298,876)
Proceeds from maturities and sales of investments	216,350	222,599
Capital expenditures	(22,876)	(14,689)
Acquisitions, net of cash acquired	—	300
Purchases of equity and cost method investments	(10,304)	—
Other, net	(4)	875
Cash provided by (used for) investing activities	48,237	(89,791)
Financing activities		
Proceeds from stock-option exercises, net	2,760	6,630
Excess tax benefits from stock-option exercises and vesting of restricted stock units	5,007	7,621
Common shares repurchased	(183,698)	(28,526)
Dividends paid	(14,867)	(7,539)
Other, net	(18)	(363)
Cash used for financing activities	(190,816)	(22,177)
Effect of exchange rate changes on cash and cash equivalents	2,007	(254)
Net decrease in cash and cash equivalents	(48,256)	(5,906)
Cash and cash equivalents—beginning of period	200,437	180,176

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Cash and cash equivalents—end of period	\$152,181	\$174,270
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$33,163	\$28,437
Supplemental information of non-cash investing and financing activities:		
Unrealized gain (loss) on available-for-sale investments	\$2,221	\$(2,598)

See notes to unaudited condensed consolidated financial statements.

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MORNINGSTAR, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation of Interim Financial Information

The accompanying condensed consolidated financial statements of Morningstar, Inc. and subsidiaries (Morningstar, we, our, the Company) have been prepared to conform to the rules and regulations of the Securities and Exchange Commission (SEC). The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, revenue, and expenses. Actual results could differ from those estimates. In the opinion of management, the statements reflect